Report

of the

Examination of

Retail Lumbermens Mutual Insurance Company of Wisconsin

Germantown, Wisconsin

As of December 31, 1997

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November 10, 1998

Honorable Alfred W. Gross
Chairperson, Financial Condition (EX4)
Subcommittee
Commissioner of Insurance
State of Virginia
1300 East Main Street
Richmond, VA 23218

Honorable Sally McCarty
Secretary, Midwestern Zone III, NAIC
Commissioner of Insurance
State of Indiana
311 West Washington Street, Suite 300
Indianapolis, IN 46204-2787

Honorable Connie O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, WI 53702

Commissioners:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

RETAIL LUMBERMENS MUTUAL INSURANCE COMPANY OF WISCONSIN
Germantown, WI

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1993 as of December 31, 1992. The current examination covered the intervening period ending December 31, 1997, and included a review of such 1998 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employes' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company’s operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results” contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

Retail Lumbermens Mutual Insurance Company of Wisconsin (RLMICW) was organized in 1895.

The company writes direct premium in the following states:

Wisconsin	$955,554	62.5%
Michigan	304,177	19.9
Minnesota	262,261	17.1
South Dakota	7,981	0.5
		100.0%

RLMICW provides fire, inland marine, commercial multiple peril, and allied lines coverage to companies in the lumber industry. The writings for the company's fire coverage makes up 68% of its direct premiums, while allied lines, inland marine, and commercial multiple peril are 16%, 15%, and 1% of direct premiums respectively. Approximately 70% of all business is written on a direct basis. The remaining 30% is written by independent agents. Agents receive commissions of 5% to 20% of collected premium.

The following table is a summary of the net insurance premiums written by the company in 1997. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Fire	$1,036,184	$0	$792,019	$244,165
Allied lines	244,444	0	194,068	50,376
Commercial multiple peril	18,603	0	16,735	1,868
Inland marine	230,742	0	164,901	65,841
Total All Lines	$1,529,973	$0	$1,167,723	$362,250

As noted above, RLMICW provides fire, inland marine, commercial multiple peril, and allied lines coverage to companies in the lumber industry. RLMICW markets insurance coverage to sawmills, retail lumberyards, wholesale lumberyards, dry kilns, loggers, and woodworkers. The inland marine line primarily consists of insurance written on logging equipment and equipment used by lumberyards.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of nine members. Three directors are elected annually to serve a three-year term. Officers are elected at the board's annual meeting. The chairman of the board receives $400 for each regular meeting and $200 for any separate committee meeting attended. All other board members receive $300 for each regular meeting attended and $150 for any separate committee meeting attended. All directors are reimbursed for any business-related out-of-pocket expenses, such as travel, lodging, and meals. Mileage is currently reimbursed at 31 cents per mile.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Lester F. Berns Sturgeon Bay, WI	Retired	2000
Richard M. Connor, Jr. Long Lake, WI	Owner of lumber manufacturing property	1999
Steven B. Forrest Lake Tomahawk, WI	Owner of retail lumber property	2000
Robert C. Heebink Cornucopia, WI	Owner of lumber manufacturing property	1999
Alan H. Kison Richfield, WI	President of RLMICW	1999
Ronald P. Kneebone Madison, WI	Owner of retail lumber property	2001
Tim D. Meeder Manclona, MI	Owner of lumber manufacturing property	2001
Stanley A. Tortenson Twin Lakes, WI	Owner of retail lumber property	2001
Dennis G. Wood Bangor, WI	Retired	2000

Officers of the Company

The officers appointed by the board of directors and serving at the time of this examination are as follows:

Name	Office	Compensation
Alan H. Kison	President	$68,006
Richard M. Smith	Executive Vice President	60,189
Scott H. Gumm	Vice President	45,542
Robert C. Heebink	Treasurer	900
Richard M. Connor, Jr.	Secretary	600

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee
Ronald P. Kneebone, Chair
Lester F. Berns
Richard M. Connor, Jr.
Robert C. Heebink
Alan H. Kison

Audit Committee
Stanley A. Torstenson, Chair
Stephen B. Forrest
Dennis G. Wood

Finance Committee
Robert C. Heebink, Chair
Richard M. Connor, Jr.
Alan H. Kison
Tim D. Meeder

Personnel Committee
Dennis G. Wood, Chair
Lester F. Berns
Stephen B. Forrest
Stanley A. Torstenson

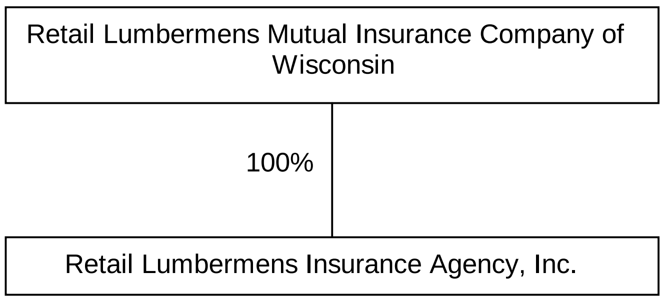
Nominating Committee

The audit, executive, finance, and personnel committees are standing committees. The chairman of the board makes appointments to each of these committees at the April annual board meeting. The board chairman also makes appointments to the nominating committee as needed.

IV. AFFILIATED COMPANIES

Retail Lumbermens Mutual Insurance Company is a member of a holding company system. It is the ultimate parent. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of RLMICW follows the organizational chart.

Organizational Chart
As of December 31, 1997



Retail Lumbermens Insurance Agency, Inc.

Retail Lumbermens Insurance Agency, Inc., is a wholly owned subsidiary of Retail Lumbermens Mutual Insurance Company of Wisconsin. The insurance agency is available to RLMICW's insureds for business that it cannot or will not write (e.g., liability and worker's compensation). Retail Lumbermens Insurance Agency, Inc., places this business with an appropriate insurer and receives a commission. There is a cost-sharing agreement between the insurance company and the agency whereby, the agency reimburses the insurance company for expenses it incurs.

V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions.

Ceding Contracts

1.	Type:	Property Per Risk Excess of Loss
	Reinsurer:	American Reinsurance Company
	Lines covered:	Fire, allied lines, inland marine, burglary, theft, and plate glass.
	Effective date:	January 1, 1994, continuous, last amended effective January 1, 1998.
	Company retention:	\$100,000 each risk, each occurrence.
	Reinsurer limit:	\$100,000 each risk, each occurrence.
	Premium:	100% of the reinsurance losses divided by the subject written premium plus a reinsurance charge of 5% of subject written premium. The final premium is subject to a minimum/maximum premium of 5%/20% of subject written premium. The current rate is 10.8%.
	Termination:	Either party may terminate the agreement by giving not less than 90 days' written notice prior to the annual anniversary date.
2.	Type:	First Surplus
	Reinsurer:	American Reinsurance Company
	Lines covered:	Fire, allied lines, inland marine, burglary, theft, and plate glass.
	Effective date:	January 1, 1985, continuous, last amended effective January 1, 1994.
	Company retention:	\$200,000 per any one risk.
	Reinsurer limit:	Up to four times the net retained liability, not to exceed \$500,000 of any one risk.
	Premium:	Pro rata share of the company's premium and additional premiums, if any, for the period covered.
	Commission:	36% sliding scale. Minimum/maximum of 36/45%.
	Termination:	May be cancelled effective December 31st by either party giving 90 days' prior written notice.
3.	Type:	Property Facultative

Reinsurer:	American Reinsurance Company
Lines covered:	Fire, allied lines, inland marine, burglary, theft, and plate glass.
Effective date:	October 1, 1980.
Company retention:	No retention level is specified in the contract.
Reinsurer limit:	Pro rata coverage equal to three times the company's net and treaty retention on any one risk, not to exceed $1,800,000. Risk written and/or ceded on an excess of loss basis must have prior approval from the reinsurer.
Premium:	100% of net premiums on ceded risk less the provisional commission.
Provisional commission:	30% of net written premium ceded under this contract to be adjusted on the reinsurer's loss ratio. Maximum/minimum commissions of 30/20%.
Contingent commission:	20% of annual net profit.
Termination:	By either party upon at least 90 days' written notice, or at any time by mutual consent.

4.

Type:	Property Facultative Automatic Agreement.
Reinsurer:	Swiss Re America
Lines covered:	All property lines covered under the company's policies.
Effective date:	January 1, 1995. Shall remain in force until cancelled.
Company retention:	$700,000
Reinsurer limit:	$700,000
Premium:	The reinsurer's pro rata participation percentage of the company's original premium.
Commission:	30% of ceded premiums.
Termination:	Either party may terminate the agreement by giving 90 days' written notice.

5.	Type:	Property Facultative Automatic Agreement
	Reinsurer:	Kemper Reinsurance Company
	Lines covered:	All property lines covered under the company's policies.
	Effective date:	January 1, 1997. Continuous until cancelled.
	Company retention:	$700,000
	Reinsurer limit:	$700,000
	Premium:	The reinsurer's pro rata participation percentage of the company's original premium.
	Commission:	30% of ceded premiums.
	Termination:	Either party may terminate the agreement by giving 90 days' written notice.
6.	Type:	Excess Aggregate Loss Ratio
	Reinsurers:	TOA Reinsurance Company of America
	Lines Covered:	Fire, allied lines, inland marine, and commercial multiple peril (non-liability portion).
	Effective date:	April 1, 1998
	Company retention:	Layer A: Net losses incurred up to 85% of the company's net premiums earned plus 64% of the first $40,000 in losses over the 85% retention point. In addition, there is a $40,000 loss corridor between layer A and layer B which the company retains.
		Layer B: 64% of losses incurred over the first $80,000 in losses incurred above the 85% retention point.
	Reinsurer limit:	Layer A: 36% of the first $40,000 in net losses incurred in excess of 85% of the company's net premiums earned.
		Layer B: 36% of losses incurred over the first $80,000 in losses incurred above the 85% retention point, with a limit of liability to the reinsurer of the lesser of 135% of net premiums earned or $637,500.
	Premium:	5.316% of the company's net earned premium, subject to a minimum premium of 18,080.
	Termination:	January 1, 1999

7.	Type:	Facultative (Certificate basis only)
	Reinsurer:	Everest Reinsurance Company
	Lines Covered:	All risk, excluding flood and earthquake, on building, equipment, stock, business interruption, and inland marine.
	Effective date:	Policy effective date.
	Company retention:	$3,900,000
	Reinsurer limit:	Will reinsure the amount accepted on the certificate. The amount accepted on the certificate is equal to the total insured value minus $3.9 million. Note, the company will not insure risks over $3.9 million if Everest does not agree to reinsure the risk.
	Premium:	The reinsurer's pro rata participation percentage of the company's original premium.
	Commission:	25% to 27.5%.
	Termination:	Policy termination date.

The terms of the Excess Aggregate Loss Ratio contract (#6 above) specify that the company will retain only 10% and reinsure 90% of the losses over the 85% retention point. However, only 40% of the contract was subscribed. Therefore, this report states the company's retention net of the 40% subscription.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 1997, annual statement to the Commissioner of Insurance. Adjustments made as a result of the examination are noted in the section of this report captioned "Reconciliation of Surplus per Examination." Also included in this section are schedules which reflect the growth of the company, comments on any exceptional *NAIC Insurance Regulatory Information System (IRIS)* ratio results for the period under examination, and the compulsory and security surplus calculation.

Retail Lumbermens Mutual Insurance Company of Wisconsin
Assets
As of December 31, 1997

	Ledger Assets	Nonledger Assets	Nonadmitted Assets	Admitted Assets
Bonds	$861,511	$	$	$861,511
Stocks:				
Preferred stocks				
Common stocks	309,455	299,184		608,629
Real estate:				
Occupied by the company	123,177			123,177
Other properties				
Cash	86,761			86,761
Short-term investments				
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	325,480		2,465	323,015
Funds held by or deposited with reinsured companies	6,000			6,000
Reinsurance recoverables on loss and adjustment payments	305			305
Federal income tax recoverable		36,604		36,604
Electronic data processing equipment	25,962			25,962
Interest, dividends, and real estate income due and accrued		18,127		18,127
Receivable from parent, subsidiaries, and affiliates	7,840			7,840
Equipment, furniture, and supplies	35,746		35,746	
Total Assets	$1,782,227	$353,915	$38,211	$2,097,931

Retail Lumbermans Mutual Insurance Company of Wisconsin
Liabilities, Surplus, and Other Funds
As of December 31, 1997

Losses	$ 8,235
Loss adjustment expenses	9,613
Other expenses (excluding taxes, licenses, and fees)	15,540
Taxes, licenses, and fees (excluding federal and foreign income taxes)	7,126
Unearned premiums	236,594
Funds held by company under reinsurance treaties	24,767
Total Liabilities	301,875
Unassigned funds (surplus)	1,796,056
Surplus as Regards Policyholders	1,796,056
Total Liabilities, Surplus, and Other Funds	$2,097,931

Retail Lumbermans Mutual Insurance Company of Wisconsin
Summary of Operations
For the Year 1997

Underwriting Income	
Premiums earned	$370,036
Deductions	
Losses incurred	302,540
Loss expenses incurred	80,235
Other underwriting expenses incurred	328,661
Total underwriting deductions	711,526
Net underwriting gain or loss	(341,490)
Investment Income	
Net investment income earned	59,885
Net realized capital gains or losses	119,214
Net investment gain or loss	179,099
Other Income	
Net gain or loss from agents' or premium balances charged off	(5,817)
Finance and service charges not included in premiums	4,863
Write-ins for miscellaneous income:	5,373
Total other income	4,419
Net income before dividends to policyholders and before federal and foreign income taxes	(157,972)
Net income after dividends to policyholders but before federal and foreign income taxes	(157,972)
Federal and foreign income taxes incurred	(36,604)
Net Income	$(121,368)

Retail Lumbermans Mutual Insurance Company of Wisconsin
Cash Flow
As of December 31, 1997

Premiums collected net of reinsurance	$347,835		
Loss and loss adjustment expenses paid (net of salvage or subrogation)	332,601		
Underwriting expenses paid	329,509		
Cash from underwriting		$(314,275)	
Investment income (net of investment expense)		64,009	
Other income (expenses):			
Agents' balances charged off	(5,817)		
Net funds held under reinsurance treaties	1,000		
Net amount withheld or retained for account of others	(165)		
Write-ins for miscellaneous items:	6,204		
Total other income		1,222	
Deduct:			
Federal income taxes recovered		40,233	
Net cash from operations			$(208,811)
Proceeds from investments sold, matured, or repaid:			
Bonds	165,906		
Stocks	95,807		
Real estate	125,000		
Total investment proceeds		385,993	
Cost of investments acquired (long-term only):			
Bonds	51,969		
Stocks	61,473		
Real estate	125,000		
Total investments acquired		239,368	
Net cash from investments			146,625
Cash provided from financing and miscellaneous sources:			
Other cash provided	39,781		
Total		39,781	
Cash applied for financing and miscellaneous uses:			
Other applications	14,023		
Total		14,023	
Net cash from financing and miscellaneous sources			25,758
Net change in cash and short-term investments			(36,428)
Reconciliation			
Cash and short-term investments, December 31, 1996			123,189
Cash and short-term investments, December 31, 1997			$ 86,761

Retail Lumbermens Mutual Insurance Company of Wisconsin
Compulsory and Security Surplus Calculation
December 31, 1997

Assets		$2,097,931	
Less liabilities		301,875	
Adjusted surplus			$1,796,056
Annual premium:			
All other insurance	$362,250		
Factor	20%		
Total		72,450	
Compulsory surplus			72,450
Compulsory surplus excess (or deficit)			$1,723,606
Adjusted surplus			$1,796,056
Security surplus: (140% of compulsory surplus)			101,430
Security surplus excess (or deficit)			$1,694,626

The company is exempt from the ordinary $2 million minimum surplus requirement since it was incorporated to do business in Wisconsin before 1982.

Retail Lumbermens Mutual Insurance Company of Wisconsin
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 1997

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1993	1994	1995	1996	1997
Surplus, beginning of year	$1,963,616	$1,908,109	$2,016,912	$1,973,975	$1,818,867
Net income	126,682	106,250	(101,207)	(124,473)	(121,368)
Net unrealized capital gains or (losses)	(168,446)	(3,750)	18,262	(32,032)	100,411
Write-ins for gains and (losses) in surplus:	0	0	0		
Audit adjustment			27,314		
Surplus, end of year	$1,908,109	$2,016,912	$1,973,975	$1,818,867	$1,796,056

Retail Lumbermens Mutual Insurance Company of Wisconsin
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 1997

Ratio No. 1—Gross Premiums to Capital and Surplus
NAIC exceptional results are any values greater than or equal to 900%

Company Results -	1993	73%
	1994	72
	1995	78
	1996	86
	1997	85

Ratio No. 1A—Net Premiums to Capital and Surplus
NAIC exceptional results are any values greater than or equal to 300%

Company Results -	1993	23%
	1994	24
	1995	22
	1996	15
	1997	20

Ratio No. 2—Change in Net Writings
NAIC exceptional results are any values greater than or equal to 33% or less than or equal to -33%

Company Results -	1993	10%
	1994	13
	1995	-11
	1996	-38*
	1997	36*

Ratio No. 3—Surplus Aid to Capital and Surplus
NAIC exceptional results are any values greater than or equal to the maximums listed below:

			MAX
Company Results -	1993	9%	15.0
	1994	8	15.0
	1995	8	15.0
	1996	9	15.0
	1997	9	15.0

Ratio No. 4—Two-year Overall Operating Ratio
NAIC exceptional results are any values greater than or equal to 100%

Company Results -	1993	101%*
	1994	81
	1995	111 *
	1996	177 *
	1997	191 *

Ratio No. 5—Investment Yield
NAIC exceptional results are any values outside the maximum and minimum values listed below:

			MAX	MIN
Company Results -	1993	3.1%*	10%	4.5%
	1994	3.5 *	10	4.5
	1995	3.6 *	10	4.5
	1996	3.9 *	10	4.5
	1997	3.6 *	10	4.5

Ratio No. 6—Change in Capital and Surplus
NAIC exceptional results are any values greater than or equal to +50% or less than or equal to -10%

Company Results -	1993	-3%
	1994	6
	1995	-3
	1996	-7
	1997	-1

Ratio No. 7—Liabilities to Liquid Assets
NAIC exceptional results are any values greater than or equal to 105%

Company Results -	1993	26%
	1994	18
	1995	24
	1996	32
	1997	26

Ratio No. 8—Agents' Balances to Surplus
NAIC exceptional results are any values greater than or equal to 40%

Company Results -	1993	25%
	1994	29
	1995	24
	1996	20
	1997	19

Ratio No. 9—One-year Reserve Development
NAIC exceptional results are any values greater than or equal to the maximums listed below:

			MAX
Company Results -	1993	-2.0%	20.0
	1994	-1.0	20.0
	1995	-1.0	20.0
	1996	-1.0	20.0
	1997	0.0	20.0

Ratio No. 10—Two-year Reserve Development
NAIC exceptional results are any values greater than the maximums listed below:

			MAX
Company Results -	1993	-1.0%	20.0%
	1994	0.0	20.0
	1995	-1.0	20.0
	1996	-1.0	20.0
	1997	0.0	20.0

Ratio No. 11— Estimated Current Reserve Deficiency to Surplus
NAIC exceptional results are any values greater than or equal to 25%

			MAX
Company Results -	1993	0.0%	25.0%
	1994	0.0	25.0
	1995	3.0	25.0
	1996	3.0	25.0
	1997	0.0	25.0

The change in net writings ratio was exceptional in 1996 and 1997. The net premiums written dropped 38% in 1996, as a result of a provision in its property per risk excess of loss contract. The contract called for a large increase in premiums ceded because of the company's poor loss experience. In 1997, the company did not have to cede as much business to the reinsurer. Thus, the net premiums written increased 36%.

The two-year overall operating ratio was exceptional in 1993 and 1995-1997. The exceptional ratios are a result of a high loss ratio that has been over 100% the last three years and an expense ratio has been extraordinarily high at 89%, 107%, 68%, 56%, and 50% the last five years respectively. In 1997, 96% of the company's expenses consisted of salary-related expenses. The loss ratio has been exceptionally high the last three years due to the increase in severity of losses.

The company incurred exceptionally low investment yields in the years 1993-1997. The low investment yields can also be attributed to the company's high expense structure. The company incurred $18,113 in investment expenses in 1997, 45% of which were related to salaries. As a result, these high expenses reduce the company's net investment earnings.

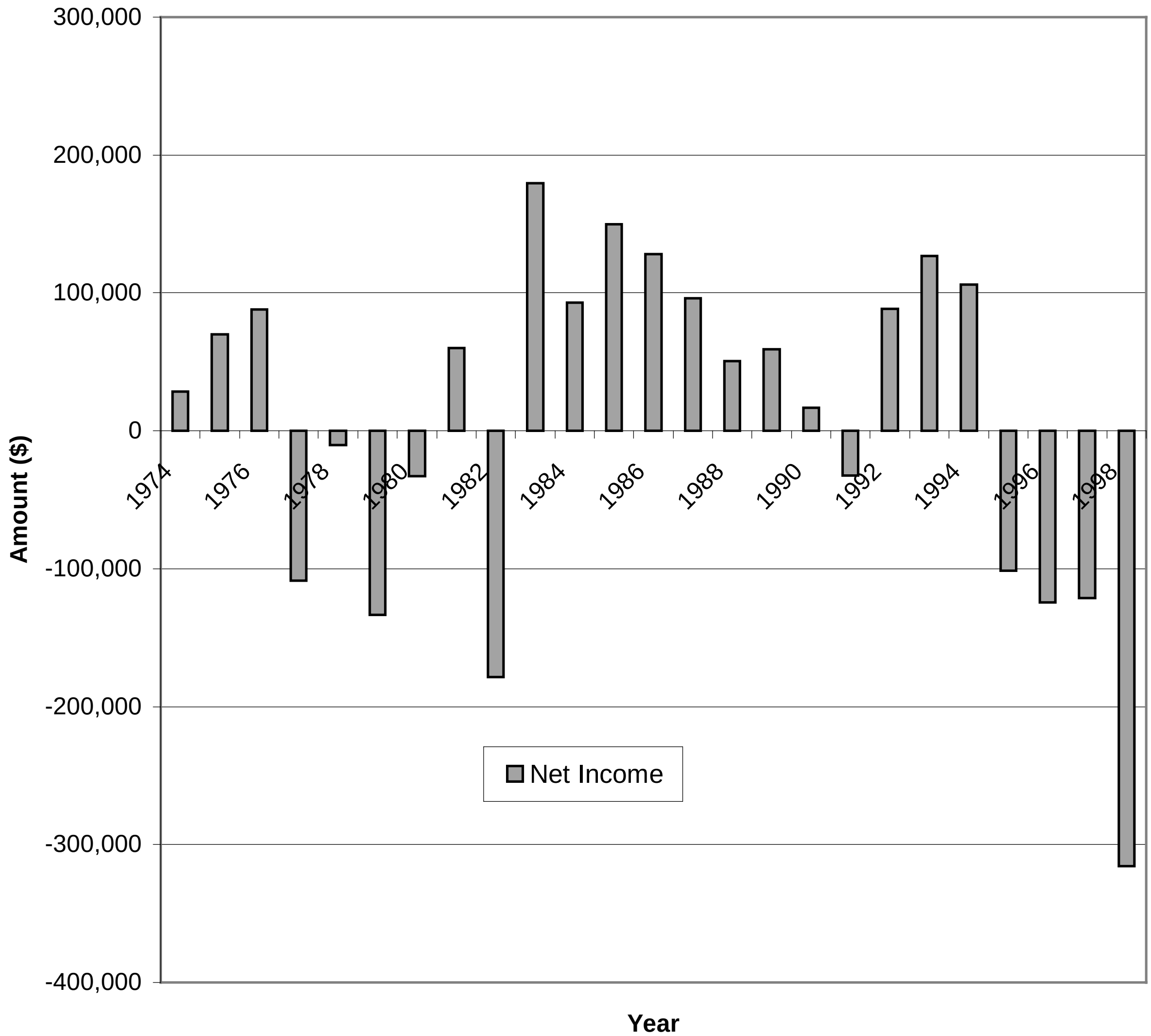
Growth of Retail Lumbermans Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1993	$2,349,322	$441,213	$1,908,109	$ 126,682
1994	2,312,026	295,114	2,016,912	106,250
1995	2,240,247	293,586	1,946,661	(101,207)
1996	2,116,266	297,399	1,818,867	(124,473)
1997	2,097,931	301,875	1,796,056	(121,368)
1998	1,832,555	354,805	1,477,760	(315,448)

Year	Gross Premium Written	Net Premium Written	Premium Earned	Direct Loss & Lae Ratio	Net Loss And LAE Ratio	Expense Ratio	Combined Ratio
1993	$1,388,067	$431,406	$422,468	40.6	60.6%	49.5%	110.1%
1994	1,451,114	486,400	458,263	30.3	32.2	56.2	88.4
1995	1,509,060	431,096	428,570	78.0	104.1	67.9	172
1996	1,562,072	265,460	284,243	71.1	118.1	107.5	225.6
1997	1,529,973	362,250	370,036	98.8	103.5	88.8	192.3
1998	1,482,241	350,969	368,456	197.8	161.2	84.7	245.9

Note: 1998 results have been included here to illustrate the continued financial trends.

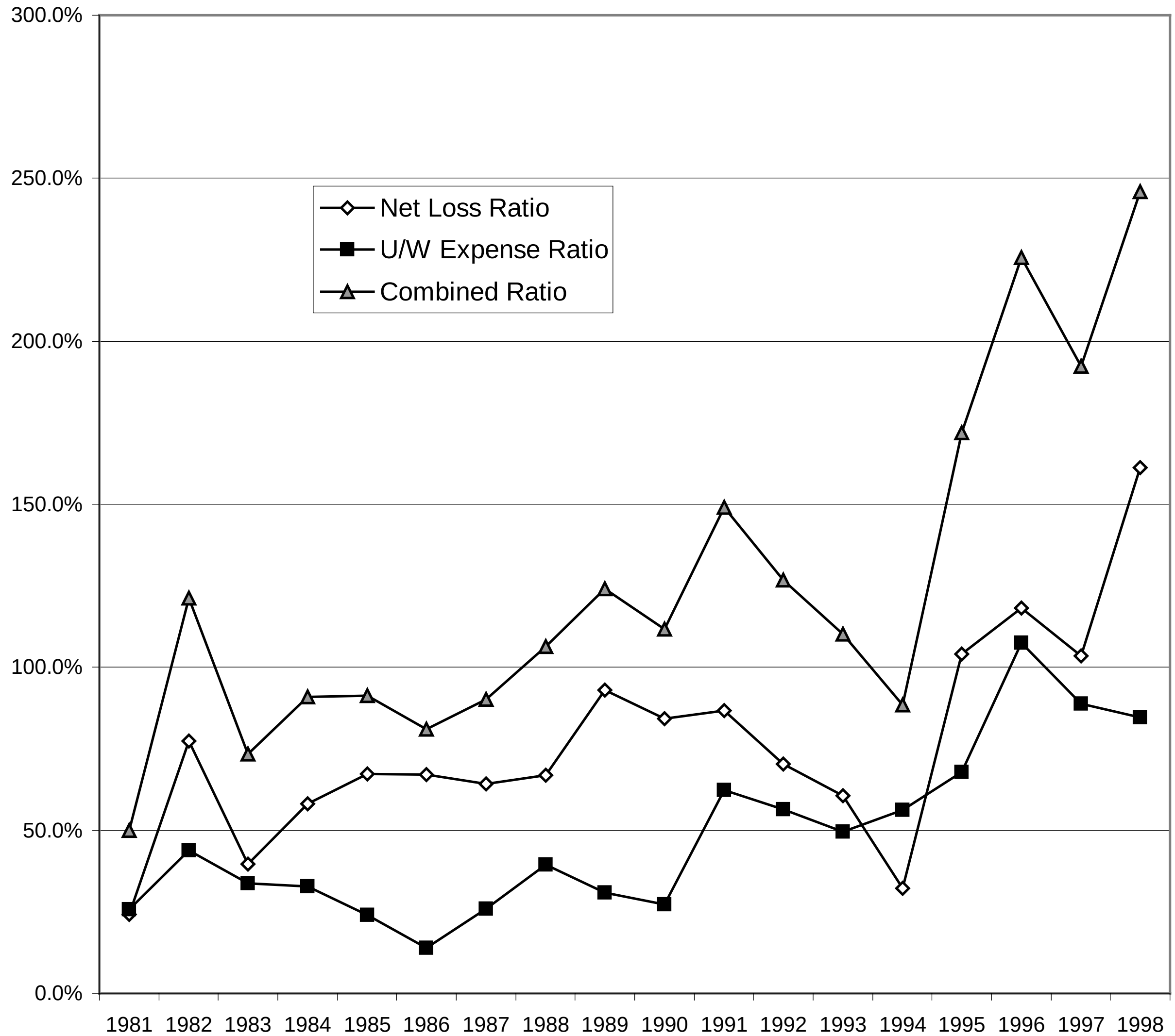
Net Income



The above tables and graph illustrate the company's negative financial trends. Since 1995, the company has incurred extraordinarily high combined ratios, which indicates operating results have been poor. As noted in the section on IRIS ratios, the company operates under a high expense structure. The most significant expense contributing to the company's high expense structure is salaries.

Additionally, the company's loss ratio has been exceptionally high since 1995. As a result of the increased severity of fire losses, the company was unable to fully subscribe its excess of loss ratio reinsurance contract. Two of the company's reinsurers discontinued coverage on the excess of loss ratio contract in 1998 due to the poor loss experience.

Furthermore, in the current soft market the company is operating in, its inability to compete on rates may be causing some adverse selection. The graph below illustrates how the company's loss ratio, underwriting expense ratio, and combined ratio has significantly increased in the recent years as compared to results of the 1980's.



Due to the high expense and loss ratios the company has incurred, its surplus has dropped by 26.7% since 1994. Accelerating the negative financial trend is the fact that company will have less capital to create investment gains needed to offset its underwriting losses.

The following table provides an analysis of losses over $20,000 by line of business. The table was derived from loss information from 1989-1998 provided by the company. The table illustrates the company's two largest lines of business have historically operated at high loss ratio percentages. It can also be seen that the company's average loss ratio for all losses for the ten-year period is high.

Line of business	Premium Written	Losses over $20,000	Loss Ratio
Sawmills/Planing Mills	3,735,927	3,313,744	88.7
Dry kilns, all other mfg and whole sale lumber	5,070,186	4,210,207	83.1
Retail Lumber	2,401,667	1,688,761	70.3
Inland Marine	2,001,389	812,346	40.6
Miscellaneous	133,426	105,324	79.0
Totals	13,342,595	10,130,382	75.9
All Losses	13,342,595	11,371,185	85.2

Reconciliation of Surplus per Examination

The following schedule is a reconciliation of members' surplus between that reported by the company and as determined by this examination:

	Increase	Decrease	
Surplus December 31, 1997, per annual statement			$1,796,056
Real Estate Occupied By The Company		$(73,669)	
Other Expenses		$(36,487)	
Net increase or (decrease)		$(110,156)	(110,156)
Surplus December 31, 1997, per examination			$1,685,900

There were no account reclassifications as a result of the examination work performed.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were six specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Annual Statement—It is recommended that the company develop and implement procedures, which eliminate reporting errors in its annual statement.

   Action — Compliance.

2. Invested Assets—It is again recommended that the company obtain a new custodial agreement whereby the holder of the securities is obligated to indemnify the company for any losses of securities in the holder's custody, in accordance with the specifications outlined in the NAIC's Examiners Handbook.

   Action — Noncompliance. See section of the exam report "invested assets".

3. Stocks—In accordance with the VOS instructions, it is recommended that the company file an SAR with the Securities Valuation Office for any nonaffiliated investment which is not listed in the VOS.

   Action — Compliance.

4. Stocks—It is recommended that the company limit future investments in common stock of a single corporation and its affiliates to 3% of assets, in accordance with s. 620.23 (2) (a), Wis. Stat.

   Action — Compliance.

5. Short-Term Investments—It is recommended that the company report the value of its short-term investments in accordance with annual statement instructions.

   Action — Compliance.

6. Unearned Premium—In order to provide auditable records which can be reconciled to original source documents, it is recommended that the company produce a printed report which details the composition of its unearned premiums balance.

   Action — Compliance.

Summary of Current Examination Results

Articles and Bylaws

The bylaws of the company state that ten members present in person shall constitute a quorum for the transaction of business at any meeting of the members. The 1998 annual meeting of the members was held without a quorum; only nine policyholders were present. It is recommended that the company hold future meetings of its members in accordance with the bylaws of the corporation.

Electronic Data Processing Environment

A review of the EDP environment noted that the company does not have virus protection software. Although the company's exposure to viruses is limited, it is recommended that the company purchase virus protection software. Additionally, it was noted that the company does not have a disaster recovery plan. It is recommended that the company establish a disaster recovery plan.

Invested Assets

As a result of the prior examination, it was recommended that the company obtain a new custodial agreement whereby the holder of the securities is obligated to indemnify the company for any losses of securities in the holder's custody. The company obtained a new contract, but the proper indemnification clause was not included. It is again recommended that the company obtain a custodial agreement whereby the holder of the securities is obligated to indemnify the company for any losses of securities in the holder's custody, in accordance with the specifications outlined in the NAIC's Examiners Handbook. The new agreement should include the following language from the Examiners Handbook:

1. The bank or trust company as custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the bank or trust company's custody occasioned by the negligence or dishonesty of the bank or trust company's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction.

2. That in the event that there is a loss of the securities for which the bank or trust company is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

The examination noted the company failed to complete Column 15 (the effective rate of interest) of Schedule D, Part 1 of the annual statement. It is recommended that the company complete Schedule D, Part 1, Column 15 of the annual statement in future filings.

Real Estate Occupied By The Company

During 1997 Retail Lumbermens Mutual Insurance Company moved from one condominium unit to another within the same complex. They exchanged units with another party who owned a unit. The company treated the transaction as a sale, realizing a capital gain, and recorded the step-up in book value on the annual statement. The transaction should have been treated as a like-kind exchange of property without a gain on the sale of the property being recognized. Thus, the examination reduced the real estate account by the amount of the capital gain realized, $73,669, decreasing surplus by a like amount. It is recommended that the company not record capital gains on like-kind exchanges of real estate in the future.

Other Expenses

The company accrued $15,540 for expenses, of which $6,513 was for accrued sick leave pay out. The company has a policy of paying out unused sick leave days (up to 90 days) to employees who leave for any reason. The employee's current years unused sick leave is paid out at a rate of 100%, while prior years accumulated sick leave is paid out at a rate of 50%. The examiners determined this accrual to be $43,000. Thus, the examination will increase this liability by $36,487 and reduce surplus by the same amount. It is recommended that the company fully accrue for its sick leave pay out on future annual statements.

Historical Financial Trends

As noted in the section of the report "Growth of Retail Lumbermans Mutual Insurance Company," the company has experienced severe negative financial trends since 1995. In an effort to reduce the high expense ratio the company has experienced, it is recommended that the company do a comprehensive study of its expense structure, which indicates areas where the company can make significant cutbacks in expenses. It is further recommended that the company take the necessary actions needed to improve its expense structure within a reasonable time frame.

Secondly, in an effort to improve its financial position, it is recommended that the company develop a comprehensive business plan, which indicates what the company goals are and how they will achieve its goals. The business plan should include topics such as, invested assets, lines of business it operates in, premium growth, surplus growth, marketing efforts, reinsurance, inspections, containment of expenses, underwriting, and consider the alternative of merger. The marketing aspect of the plan should indicate how the company would retain a higher percentage of customers.

Reinsurance

The company incorrectly reported a $6,000 premium adjustment from one of its reinsurers as “funds held by or deposited with reinsured companies”. The “funds held by or deposited with reinsured companies” line should only be used by companies who assume reinsurance. The reinsurance premium adjustment should be reported on the “premiums and agents’ balances in course of collection (after deducting ceded reinsurance balances payable)” line, or as a write-in item. Thus, it is recommended that the company report premium adjustments from its reinsurers on the appropriate line of the balance sheet. The examination did not reclassify this item because it was immaterial in relation to the financial position of the company.

VIII. CONCLUSION

Retail Lumbermens Mutual Insurance Company has seen its surplus decrease significantly since the prior examination. From 1994-1998, surplus decreased 26.7%. In 1998 the company incurred a net loss of $315,448, the worst loss year in company history; as a result, surplus was down to $1,477,760 at year-end 1998. The examination resulted in two adjustments, which decreased surplus by $110,156. There were eleven recommendations as a result of the examination. The most significant recommendations relate to reduction of expenses, and the recommendation that the company develop a business plan. In light of the l998 financial results, it is essential that the board of directors explore merger as an alternative to restoring its operations to profitability.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 26 - Articles and By-laws — It is recommended that the company hold future meetings of its members in accordance with the bylaws of the corporation.

2. Page 26 - Electronic Data Processing Environment — It is recommended that the company purchase virus protection software.

3. Page 26 - Electronic Data Processing Environment — It is recommended that the company establish a disaster recovery plan.

4. Page 26 - Invested Assets — It is again recommended that the company obtain a custodial agreement whereby the holder of the securities is obligated to indemnify the company for any losses of securities in the holder's custody, in accordance with the specifications outlined in the NAIC's Examiners Handbook.

5. Page 27 - Invested Assets — It is recommended that the company complete Schedule D, Part 1, Column 15 of the annual statement in future filings.

6. Page 27 - Real Estate Occupied by the Company — It is recommended that the company not record capital gains on like-kind exchanges of real estate in the future.

7. Page 27 - Other expenses — It is recommended that the company fully accrue for its sick leave pay out on future annual statements.

8. Page 27 Historical Financial Trends — It is recommended that the company do a comprehensive study of its expense structure, which indicates areas where the company can make significant cutbacks in expenses.

9. Page 27 Historical Financial Trends — It is further recommended that the company take the necessary actions needed to improve its expense structure within a reasonable time frame.

10. Page 27 - Historical Financial Trends — It is recommended that the company develop a comprehensive business plan, which indicates what the company goals are and how they will achieve its goals. The business plan should include topics such as, invested assets, lines of business it operates in, premium growth, surplus growth, marketing efforts, reinsurance, inspections, containment of expenses, underwriting, and consider the alternative of merger. The marketing aspect of the plan should indicate how the company would retain a higher percentage of customers.

11. Page 28 Reinsurance — It is recommended that the company report premium adjustments from its reinsurers on the appropriate line of the balance sheet.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employes of the company is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Bureau of Financial Analysis and Examinations

Glenn Aumann	Insurance Examiner

Respectfully submitted,

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